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November 14, 2005

#### **AGENDA ITEM 6.b**

# TO: MEMBERS OF THE INVESTMENT COMMITTEE

I. SUBJECT: Selection of Environmental Equity Managers for

Spring-Fed Pool and Term of Contracts

II. PROGRAM: Global Equity

**III. RECOMMENDATION:** (1) Approve the following group of managers for

inclusion in the Spring-Fed Pool of managers for

environmental equity investment management services, subject to successful negotiation of fees and terms:

AXA Rosenberg (U.S. Equity)
New Amsterdam Partners (U.S. Equity)
Piper Jaffray & Co. – INTECH (U.S. Equity)
State Street Global Advisors (U.S. Equity)

Brandywine (International Equity)
State Street Global Advisors (International Equity)

(2) Approve the use of annual review contracts for the Spring-Fed Pool for environmental equity management

services.

Wilshire Associate's opinion letter is shown in

Attachment 1. Wilshire's conflict of interest disclosure is

shown in Attachment 2.

### IV. ANALYSIS:

#### Background

In February 2004, the Treasurer's Office initiated an "Environmental Investment Proposal for Consideration by CalPERS and CalSTRS." This proposal is shown in Attachment 3. The Proposal, among other things, called on CalPERS to examine an investment strategy in environmentally screened public equity funds that are performing as well or better than their non-screened counterparts. Specifically, the Treasurer requested that CalPERS and CalSTRS should invest a combined \$1

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billion of their stock portfolios in environmentally screened funds through leading active public equity investment managers with proven track records.

At its April 19, 2004 meeting, the Investment Committee voted to allow staff, in its discretion, to either: (1) hire external managers for up to \$500 million total, or (2) allocate up to \$500 million in mutual funds that have good records, or (3) a combination thereof to achieve the best results for the System.

Mutual funds were considered first with an RFI issued in September 2004. Subsequently, on March 31, 2005, CalPERS invested in BGI's iShares KLD Select Social Index Fund, an Exchange Traded Fund (ETF). Current assets in this strategy are \$74.5 million.

At its April 18, 2005 meeting, the Investment Committee approved the issuance of a Request for Proposal (RFP) with a Spring-Fed Pool feature for environmental equity managers and reviewed minimum qualifications and scoring.

## Manager Search Process

The RFP, which provided for optional Investment Committee interviews of finalists, was issued on May 13, 2005. Proposals were sent to firms identified through the prior RFI search completed by staff and Wilshire Associates. In addition, the RFP was advertised in *Pensions and Investments* and the *Financial Times*.

CalPERS received thirty-one proposals for environmental investing, of which all but two met the minimum qualifications listed in the RFP.

All of the qualifying proposals were read and scored by staff (Christy Wood, Mary Cottrill, Geraldine Jimenez, Sheila Halousek, and Winston Hickox) according to the criteria listed in the RFP. The scoring categories included:

- Organization / Investment Professionals
- Investment Philosophy and Process
- Trading Process and Systems
- Performance
- Composite / Product Information

The proposals were also reviewed by Wilshire Associates.

Seven firms, representing eight proposals, were invited to interview with staff at CalPERS offices on October 19<sup>th</sup> and October 20<sup>th</sup>. Representatives from Wilshire Associates were in attendance at the interviews. The interviews were scored by

Members of the Investment Committee November 14, 2005 Page 3

staff in accordance with the criteria listed in the RFP. The scoring categories included:

- Business Strategy
- Organization / Investment Professionals
- Investment Philosophy and Process
- Trading Process and Systems
- Risk Management

Fee proposal scores were combined with the Technical Proposal and Staff Interview scores to determine the firms to be recommended to the Investment Committee.

Based on the results of the RFP process, staff and Wilshire recommend the six products listed in the recommendation section above be included in the Spring-Fed Pool of managers for environmental investing services.

### **Annual Review Contracts**

Staff recommends the use of annual review contracts, which provide for an undefined duration, for this RFP. This would be consistent with the contracting procedure used for all other investment management contracts. This recommendation is necessary to fulfill CalPERS' fiduciary duties to its members because the use of annual review contracts is a more efficient use of CalPERS staff and Board time and other resources. The award of contracts without a defined duration is allowed under Board Resolution 92-04B-4.

### Funding

Funding of managers for the environmental investing management Spring-Fed Pool will come primarily from passively managed public equity assets or cash inflows.

#### V. STRATEGIC PLAN:

Goal IX: Achieve long-term, sustainable, risk adjusted returns.

### VI. RESULTS/COSTS:

Funding to the new managers will expand the Global Equity opportunity set and is expected to enhance risk-adjusted returns in this asset class.

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Prepared by:	
Sheila Halousek	Mary C. Cottrill
Investment Officer	Senior Portfolio Manager
Winston Hickox	Christianna Wood
Special Consultant	Chief Investment Officer
Mark Anson Chief Investment Officer	



Rosalind M. Hewsenian Managing Director

October 24, 2005

Mr. Mark Anson Chief Investment Officer California Public Employees' Retirement System 400 P Street Sacramento, CA 95814

Re: Spring Fed Pool – Environmental Equity Managers

Dear Mark,

You requested Wilshire's opinion with respect to the selection of the managers interviewed and evaluated in the Environmental Equity Spring Fed Pool. Wilshire has independently reviewed each firm and participated in the interviews with Staff. We support Staff's recommendation for the constituents of the pool of managers.

# Managers Staff recommends for the Pool

The managers Staff recommends for the pool vary with respect to the stability of their organizations, the quality of their investment products and their fit specifically for CalPERS. Several of the firms that were interviewed focus only on environmental and socially-conscious investing while others use an environmental "overlay" to a non-environmental approach. Commentary on each of the firms is provided below.

# **AXA Rosenberg**

AXA Rosenberg manages a domestic product being considered for the pool. AXA Rosenberg, located in Orinda, CA, is a majority-owned subsidiary of AXA Investment Managers SA and maintains autonomy in conducting its business and its investment strategies. AXA Rosenberg uses a quantitative approach to manage this domestic product. The firm creates a value for each company in the universe by building a market value for each line of business by comparing it to stocks of companies in similar industries. By comparing this "fair value" to the stock price, AXA Rosenberg finds undervalued companies. In addition, AXA Rosenberg seeks to avoid "value traps" by forecasting next year's earnings and avoiding companies with no or slow earnings growth. AXA Rosenberg uses tight risk controls to maximize expected return with minimum deviation from the benchmark.

AXA Rosenberg's environmental approach is exclusionary. Put another way, AXA Rosenberg, in conjunction with its client and/or an outside service provider, creates a list

Mr. Mark Anson October 24, 2005 Page 2

of restricted securities. AXA Rosenberg does not monitor a company's environmental activities as some other providers do. Instead the firm relies on the restricted list to leave them with an environmentally-friendly universe from which to select securities. AXA Rosenberg does not have a dedicated environmental restricted list provider and would need to contract with one should the firm be funded.

AXA Rosenberg currently manages an international portfolio for CalPERS.

### **Brandywine Asset Management**

Brandywine manages an international product being considered for the pool. Brandywine is an independently operated subsidiary of Legg Mason located in Wilmington, DE. The firm uses a bottom-up, value-oriented approach. Brandywine seeks to identify stocks that are selling below their normal valuation levels based on price/earnings, price/cash flow and price/book value ratios. Risk is controlled at the security level by conducting a "worst-case" analysis prior to the purchase of a stock. The process produces a portfolio that spans all capitalization ranges and exhibits strong value characteristics.

Brandywine incorporates environmental research from Boston Common Asset Management, a global socially-conscious investment management firm, into its process rather than operating with a restricted list. As Brandywine's analysts are examining different companies for their investment worth, Boston Common is analyzing the company's environmental track record and management's attitudes toward the environment.

### **New Amsterdam Partners**

New Amsterdam manages a domestic product being considered for the pool. New Amsterdam, located in New York City, is 100% employee-owned and is a registered Women-Owned Business Enterprise in the state of New York. New Amsterdam combines quantitative screening with fundamental research to identify growing but reasonably priced portfolio companies. New Amsterdam builds cash flow models and performs sensitivity analysis to validate a security's expected return and the rationale for owning that security in the portfolio.

New Amsterdam include in its fundamental research an examination of each company's environmental, social, and sustainability factors. It utilizes the KLD research database as a resource and also closely examines each company's regulatory filings for overlooked pieces of information that could potentially add value. It focuses on current practices that may be damaging to the environment as well as how the company has addressed pollution and environmental issues in the past.

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# **Piper Jaffray**

Piper Jaffray provides a domestic product being considered for the pool. Piper Jaffray is a publicly traded company located in Minneapolis, MN. Piper Jaffray serves as the "product advisor" for this environmental strategy which combines environmental research and analysis by KLD, environmental screening by Piper Jaffray and investment management techniques by INTECH. Staff and Wilshire discussed that the various layers of responsibilities in this relationship may result in increased fees.

INTECH uses a mathematical, volatility-capture strategy that focuses on building portfolios of high volatility stocks with low correlations. Risk controls include screens for liquidity and bankruptcy and limits on how far a specific stock's weight may be from its weight in the index.

KLD analyzes and rates companies based on environmental criteria. Piper Jaffray uses data from KLD and from the firm's own Social Investment Analysts to produce a restricted list. INTECH is notified of which securities are restricted and removes those securities from the investable universe.

INTECH manages a domestic enhanced index portfolio for CalPERS, although the benchmark is different.

#### **State Street Global Advisors**

State Street Global Advisors (SSGA) manages both a domestic product and an international product being considered for the pool and is headquartered in Boston, MA. SSGA is a wholly owned subsidiary of State Street Corporation which is a publicly traded company. Both the domestic strategy and the international strategy are quantitatively driven using valuation, growth and sentiment as key drivers of the investment process. Both strategies have stringent risk controls which should help limit tracking error.

Innovest Strategic Value Advisors, an affiliate of SSGA, provides "eco-efficiency" ratings for each company in the investable universe. The rating is based on an analysis of environmental criteria and allows for companies to be compared within an industry or across industries.

SSGA manages CalPERS' passive international portfolio.

#### Conclusion

The six firms that Staff and Wilshire are recommending for the pool use a variety of approaches to equity investing in an environmentally responsible manner. While the depth of belief in environmental investing varies from firm to firm, it is clear that each

Mr. Mark Anson October 24, 2005 Page 4

firm has given considerable thought as to how to successfully implement those beliefs within the investment management processes.

Should you require anything further, please do not hesitate to contact us.

Sincerely,

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October 24, 2005

Ms. Anne Stausboll 400 Q Street, Room 3492 Sacramento, CA 95814

Dear Ms. Anne Stausboll:

Wilshire's policy is to provide you with full disclosure of financial relationships we have with investment management firm(s) participating in your searches that have given Wilshire their disclosure consent. Therefore, attached is a report for 2004 and 3<sup>rd</sup> quarter of 2005 with the following information:

- Wilshire service(s) provided to the firm(s)
- Total billings for all service(s) provided
- Total commissions received from the firm(s) by Wilshire's Brokerage Division\*
- Any third party soft dollar arrangement among any of the firm(s)

It is against our Code of Conduct to share this information with our consulting and funds management divisions; hence, this information is coming directly from the accounting department. We hereby respectfully request that this information (i) not be shared with anyone in Wilshire's consulting and funds management groups; and (ii) be kept confidential to the fullest extent permitted by the law.

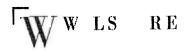
If you have any questions regarding this information, please contact me at (310) 260-7373.

Sincerely,

Ahna Santos

Accounts Receivable

<sup>\*</sup>Wilshire Brokerage terminated operations in October 2004



# WILSHIRE ASSOCIATES INCORPORATED CONFLICTS CHECK REPORT

							2005 FEES		2004 WAI BROKERAGE	2004 WAI BROKERAGE
					CLIENT		THROUGH	3RD PARTY SOFT\$	COMMISSION -	COMMISSION -
CLIENT	INVESTMENT MANAGER	WAI CLIENT NAME		SERVICE(S) PROVIDED	CONSENT	2004 FEES	3RD QTR.	ARRANGEMENT	HARD \$	SOFT \$
CALPERS	AXA ROSENBERG.		AXIOM		NO RESPONSE					
CALPERS	BRANDYWINE ASSET MANAGEMENT		ATLAS		YES	80,000.04	40,000.02	20,354.85 BNY BROKERAGE, INC.	58,655.31	87,982.94
CALPERS	BRANDYWINE ASSET MANAGEMENT	BRANDYWINE ASSET MANAGEMENT	AXIOM		YES	11,794.35	33,750.00	16,875.00		
CALPERS	ING INVESTMENT MANAGEMENT	ING ASSET MANAGEMENT	ATLAS		YES	132,500.04	40,791.65	36,000.00		
CALPERS	ING INVESTMENT MANAGEMENT	ING ASSET MANAGEMENT	AXIOM		YES	101,000.04	21,916.66	20,000.01		
CALPERS	ING INVESTMENT MANAGEMENT	ING FURMAN SELZ ASSET MGMT, LLC.	ATLAS		YES	73,800.00	36,900.00	12,710.00		
CALPERS	ING INVESTMENT MANAGEMENT	ING INVESTMENT MANAGEMENT	ABACUS		YES	105,028.27	52,750.02	26,375.01		
CALPERS	INTECH	INTECH - ENHANCED INVESTMENT TECHNOLOGY	MENTOR		YES	15,000.00	7,500.00	3,750.00		
CALPERS	NEW AMSTERDAM PARTNERS	NOT A CLIENT								
CALPERS	PARNASSUS	NOT A CLIENT		•						
CALPERS	PIPERJAFFRAY	NOT A CLIENT								
CALPERS	STATE STREET GLOBAL ADVISORS	BLACKROCK INTERNATIONAL, LTD (CASTLE)	ATLAS		YES	77,244.64	40,000.02	14,583.34 INSTINET GLOBAL SERVICES		
CALPERS	STATE STREET GLOBAL ADVISORS	STATE STREET BANK & TRUST	ATLAS		YES	19,041.70	52,125.00	26,062.50 UBS WARBURG		
CALPERS	STATE STREET GLOBAL ADVISORS	STATE STREET BANK & TRUST	<b>EQUITY M</b>	IANAGEMENT SERVICE	YES	87,000.00	43,500.00	21,750.00		
CALPERS	STATE STREET GLOBAL ADVISORS	STATE STREET BANK & TRUST	TUCS		YES	199,462.46	99,680.98	48,677.74		
CALPERS	STATE STREET GLOBAL ADVISORS	STATE STREET GLOBAL ADVISORS	ATLAS		YES	85,208.30	•		80,347.75	112,486.85
CALPERS	STATE STREET GLOBAL ADVISORS	STATE STREET RESEARCH & MGMT. CO.	AXIOM		YES	101,610.21	17,000.00			
CALPERS	STATE STREET GLOBAL ADVISORS	STATE STREET RESEARCH & MGMT. CO.	EQUITY N	IANAGEMENT SERVICE	YES	7,500.00	3,750.00	1,875.00	7,606.25	12,170.00

# OFFICE OF THE TREASURER

P. O. BOX 942809 SACRAMENTO, CA 94209-0001



# SUMMARY OF TREASURER'S ENVIRONMENTAL INVESTMENT PROPOSAL FOR CONSIDERATION BY Calpers and Calstrs

This proposal calls on CalPERS and CalSTRS to implement the following four-pronged plan:

- Demand Environmental Accountability and Disclosure. Using their financial clout in the marketplace, and building on their track record of corporate governance leadership, CalPERS and CalSTRS should prod corporations to provide meaningful, consistent and robust reporting of their environmental practices, risks and potential liabilities. Through a new environmental governance program, CalPERS and CalSTRS should encourage companies through dialogue, shareholder resolutions and other actions to improve their environmental operations and reduce their environmental risks and liabilities. As part of this effort, California's pension funds would also join with other major U.S. investors to urge more comprehensive corporate reporting of environmental practices and liabilities. The coalition's effort would include such actions as urging the Securities and Exchange Commission to strengthen environmental disclosure rules, and seeking corporate reporting on such critical financial factors as climate risk assessment and global warming.
- Target Private Investment in Environmental Technologies. CalPERS and CalSTRS should invest a combined \$500 million in private equity investments, venture capital, and project financing to develop "clean" technologies that can provide the pension funds with positive, long-term returns, and that can create jobs and economic growth in California in the years ahead. Across the globe, demographic trends, public awareness, environmental crises and increased regulation and public policy attention are driving growth in the clean technology industry. Riding this wave of technological innovation will allow CalPERS and CalSTRS to help build an industry critical to the State and nation, while earning those positive returns for pensioners and taxpayers and addressing environmental problems.
- Invest in Stocks of Environmentally Responsible Companies. CalPERS and CalSTRS should invest a combined \$1 billion of their stock portfolios in environmentally screened funds through leading active public equity investment managers with proven track records. An increasing number of recent investment research studies have shown that environmentally screened funds are outperforming their non-screened counterparts. Investing in such funds will not only provide CalPERS and CalSTRS with the opportunity for enhanced financial returns, but will also send a strong signal to corporations about the added value of responsible, forward-looking environmental practices. Under this proposal, the performance of any manager selected must equal or exceed that of the funds' existing, active managers.

• Audit real estate portfolios to boost long-term value. CalPERS and CalSTRS should undertake a comprehensive audit of their respective real estate investments to determine whether the investments are maximizing their opportunities to use clean energy, energy efficiency and green building standards and practices that reduce long-term costs and boost long-term value. CalPERS and CalSTRS have nearly \$16 billion invested in real estate and property in California, the nation and 22 countries throughout the world. CalPERS and CalSTRS own nearly 160 million square feet of office and industrial space alone.

The Treasurer requests both CalPERS and CalSTRS to put the proposal on their respective agendas for later this spring and summer.

# **Demand Environmental Accountability and Disclosure**

- Among the 20 biggest corporate emitters of greenhouse gases, 17 report that they have conducted a board-level review of climate change, according to a study by CERES.
   (Source: Douglas G. Cogan, "Corporate Governance and Climate Change: Making the Connection," Investor Responsibility Research Center (June 2003).)
- Weather damage, pollution, and industrial and agricultural losses related to global warming could cost \$300 billion annually by 2050, according to estimates by the German insurance company Munich Re. (Source: Gerhard Berz, Munich Re Geoscience Research Group, "Insuring Against Catastrophe," *Our Planet*, United Nations Environmental Programme (February 2001), as cited in Amy Cortese, "As the Earth Warms, Will Companies Pay?" *New York Times* (August 18, 2002).)
- The water industry alone could face nearly \$47 billion in additional costs within the next 50 years due to climate change, according to the head of the Geoscience Research Group at Munich Re, one of the world's largest re-insurers. (Source: Gerhard Berz, Munich Re Geoscience Research Group, "Insuring Against Catastrophe," Our Planet (United Nations Environmental Programme) (February 2001).)
- In 2001, the World Resources Institute (WRI) and the World Business Council for Sustainable Development (WBCSD) issued an international standard that enables businesses to uniformly report their emissions of greenhouse gases. The standard, called the Greenhouse Gas Protocol Initiative or "GHG Protocol," was developed over a three-year period by a partnership of over 350 individuals from corporations, non-profit organizations, and governments. Companies that use or otherwise rely upon the GHG Protocol to measure and report their emissions include Ford Motor Company, Eastman Kodak, IBM, General Electric, Lockheed Martin Corporation, U.S. Steel Corporation, and Verizon Communications. (Source: For a complete list of Protocol users, see http://www.ghgprotocol.org/standard/users.htm.)
- Concentrated risk argues for the need for better investor intelligence and information, illustrated by the fact that a small number of companies appear to face the greatest potential regulation and litigation. Only 20 petroleum and coal companies produce products that generate nearly half of the world's carbon emissions; 13 companies manufacture approximately 90 percent of the vehicles driven in the U.S.; 100 power generators are responsible for an estimated 88 percent of the greenhouse gas emissions produced by the generation of electricity in the U.S. (Source: Diane Wittenberg, California Climate Action Registry.)
- Nearly three-quarters of companies that were fined more than \$100,000 for environmental violations failed to report such damages in their annual filings, according to a 1998 EPA study. (Source: U.S. Environmental Protection Agency, "Guidance on Distributing the Notice of SEC Registrants' Duty to Disclose Environmental Legal Proceedings in EPA Enforcement Actions" (1998), as cited in Susannah Blake Goodman,

Jonas Kron, Tim Little, *The Environmental Fiduciary: The Case for Incorporating Environmental Factors into Investment Management Policies*, The Rose Foundation for Communities and the Environment (2002).)

- As much as 15 percent of the total market capitalization of major companies may be put at risk by climate change, according to Innovest Strategic Value Advisors, an investment research and advisory firm specializing in analyses of corporate performance on environmental, social, and strategic governance issues. (Source: Innovest Strategic Value Advisors, Carbon Finance Benchmarking of the U.S. Electric Utilities Industry (June 2001), as cited in Amy Cortese, "As the Earth Warms, Will Companies Pay?" New York Times (August 18, 2002).)
- Shareholders in leading oil and gas companies could lose as much as 5 to 7 percent of the value of their investments because of regulatory and other efforts to respond to climate change, according to the World Resources Institute. (Source: World Resources Institute, Changing Oil: Emerging environmental risks and shareholder value in the oil and gas industry (July 2002).)
- The discounted present value of potential carbon liabilities economic risks that a company faces relative to its sector due to carbon emissions within a single emissions-intensive manufacturing firm could represent as much as 40 percent of its entire market capitalization under certain plausible high-risk scenarios, according to the Carbon Disclosure Project, an international consortium of institutional investors representing \$4.5 trillion in assets. (Source: Carbon Disclosure Project, "Carbon Finance and the Global Equity Markets," (2003).)
- Greenhouse gas emitters could face heightened litigation costs, similar to tobacco, asbestos, mold, and manufacturers of products or processes that lead to environmental and public health harms, as awareness of the magnitude of climate change emerges. (Source: Vanessa Houlder, "Climate Change Could be Next Legal Battlefield," *Financial Times* (July 14, 2003).)

# **Target Private Investment in Environmental Technologies**

- Clean technology has emerged as the sixth largest venture investment category in the U.S. and Canada, behind information technology, software, biotechnology, health care, and telecommunications. According to Cleantech Venture Network, LLC, in 2002, investments in energy-related clean technologies represented nearly half (45.5 percent) of all clean technology investments. The remaining investments in clean technologies included enabling technologies -- technologies developed by biological, computational, and physical scientists and engineers that enable better use of natural resources and greatly reduce ecological impact (14 percent); materials and nanotechnology (13.8 percent), materials recovery and recycling (8 percent), and water-related technologies (4 percent). (Source: Cleantech Venture Network, LLC, Venture Monitor Q1 2003.)
- Venture capital investments in clean technologies were estimated to reach \$1.3 billion for the year 2003. Clean technology captured 7.4 percent of the \$4.3 billion in venture capital invested overall in the U.S. during the third quarter of 2003. In 2002, just under \$1.1 billion in venture capital was invested in 179 clean technology companies, according to Cleantech Venture Network, LLC. (Source: Cleantech Venture Network, LLC, Venture Monitor Q1 2003.)
- The global market for renewable energy is estimated to reach as much as \$625 billion by 2010, and \$1.9 trillion by 2020, according to estimates by the World Energy Council. (Source: Carbon Disclosure Project, "Carbon Finance and the Global Equity Markets," (2003).)
- California was once the leading home of wind and solar manufacturing; today, jobs in those industries are mostly found abroad. For example, 45,000 people within the European Union are now employed in wind power manufacturing. The European Wind Energy Association estimates that electricity generated by windmills will increase more than 700 percent between 2002 and 2010 in Europe. (Source: Peter Asmus, Reaping the Wind: How Mechanical Wizards, Visionaries, and Profiteers Helped Shape Our Energy Future, as cited in Clean Edge, Bringing Solar to Scale: A Proposal to Enhance California's Energy, Environmental, and Economic Security (July 2003).)
- For every megawatt of solar power, 35.5 jobs are created in manufacturing, installation, servicing, sales, and marketing, according to the Renewable Energy Policy Project. The worldwide solar PV market, including sales of modules, system components, and installations, totaled \$3.5 billion in 2002 and is projected to rise to \$27.5 billion by 2012, according to Clean Edge research. Annual global manufacturing output of solar PV modules has more than tripled in the past four years. Japan, the global solar manufacturing leader, accounted for nearly half of the manufacturing output in 2002, expanding fivefold since 1998. The U.S., the second largest producer, nearly doubled its production in just four years. (Source: Solar Catalyst Group, "Solar Opportunity Assessment Report," (December 2003).)

# **Invest in Stocks of Environmentally Responsible Companies**

- Companies that engage in environmentally responsible practices can achieve better financial results, according to a number of studies.
  - One report produced by Light Green Advisors, Inc., a Seattle-based investment advising firm, examined 20 leading empirical studies that examined the correlation between environmental and financial performance covering a 10-year range of research. Among the findings, it is reported that companies that go beyond legal compliance with environmental regulations realize stronger stock price gains and market value growth than the S&P. In contrast, laggard companies that are threatened by actual or impending environmental laws tended to experience weaker returns. (Source: Christopher J. Murphy, "The Profitable Correlation Between Environmental and Financial Performance: A Review of the Research." Light Green Advisors, Inc. (2002).)
  - O Another study, by the University of Michigan's William Davidson Institute, analyzed data from the mid-1990s on the stock market performance and environmental policies of 89 major U.S. mining and manufacturing companies with production facilities in developing nations, finding that the market valuation of companies with strict global environmental standards was some 80 percent higher, relative to their physical assets, than that of companies using local standards for their operations. (Source: Glen Dowell, Stuart Hart, Bernard Yeung, "Do Corporate Global Environmental Standards Create or Destroy Market Value?" Management Science, Vol. 46, No. 8 (August 2000).)
  - Shares of companies with good sustainability records perform better than those of their less socially responsible competitors, according to a study of over 600 companies for the period December 31, 1999 to October 27, 2003, by Germany's Ockom Research independent sustainability rating agency, in conjunction with Morgan Stanley Dean Witter. (Source: Global Finance (January 2004).)
  - Studies indicate that investment funds comprised of companies with superior environmental profiles tend to be more profitable than the S&P 500. Environmental screening appeared to raise, rather than reduce, financial returns of investment portfolios. (Source: See, for example, John Buffington and John Ganzi, "2000 Annual Review of Eco-Efficiency Funds," Finance Institute for Global Sustainability (2000); Ralph Earle, The Emerging Relationship Between Environmental Performance and Shareholder Wealth," Assabet Group (2000), as cited in Murphy (2002).)

- The Domini Social Equity 400 Index has outperformed the S&P 500 on a total-return basis and on a risk-adjusted basis since its inception in May 1990. (Source: CBS MarketWatch, January 14, 2004, quoting Peter Kinder, president of KLD Research and Analytics.)
- Environmentally and socially screened portfolios grew by 7 percent despite the market downturn of 2001 and 2002, moving these funds from the margins to the mainstream of the financial markets. In 2002, environmentally screened mutual funds held nearly \$29 billion in assets. (Source: Social Investment Forum, "2003 Report on Socially Responsible Investing Trends in the United States," (updated December 2003).)

# Audit Real Estate Portfolios to Boost Long-Term Value

- CalPERS and CalSTRS hold more than \$16 billion in real estate holdings in 22 countries around the globe, with over half of those holdings in office and industrial space. CalSTRS' Real Estate Portfolio includes 15.5 million square feet of office space worth \$2.4 billion and 32.2 million square feet of industrial space valued at \$975 million. CalPERS' Real Estate portfolio includes 16.4 million square feet of office space, worth \$2.3 billion and 95.5 million square feet of industrial space, at a value of \$2.9 billion.
- The federal government has encouraged energy efficiency through the national Energy Star program. Companies including product manufacturers, builders, and retailers that actively participated in the Energy Star program through voluntary partnerships with the U.S. Environmental Protection Agency outperformed companies that were not involved in the Energy Star program by more than 12 percent during the two-year period of 2000-2001. More than 15,000 of the nation's buildings have been rated using EPA's national energy performance rating system, and more than 1,100 buildings have earned the Energy Star label for superior energy performance. (Source: Innovest Strategic Value Advisors, "Energy Management and Investor Returns: The Real Estate Sector" (October 2002).)
- California's tough energy efficiency standards have resulted in substantial cost savings. This efficiency is due in part to stringent energy efficiency standards for buildings and appliances that have been in effect and periodically updated since 1978. Through the Energy Efficiency Standards for Residential and Nonresidential Buildings (also known as Title 24 building standards) along with standards for energy efficient appliances, California has saved more than \$20 billion in electricity and natural gas costs since 1978. It is estimated California will save \$57 billion by 2011 due to these standards. (Source: California Energy Commission, http://www.energy.ca.gov/title24/index.html.)
- Real estate companies with above average energy management performance, taken as a group, tended to outperform below average companies by approximately 34 percent on Wall Street over the two-year period of 2000-2001, according to research conducted by Innovest Strategic Value Advisors. (Source: Innovest Strategic Value Advisors, "Energy Management and Investor Returns: The Real Estate Sector" (October 2002).)
- Companies owning energy-efficient buildings demonstrate savings. For example, Southern California's largest landlord of commercial office space, which holds 129 properties consisting of 215 buildings and approximately 18.8 million net rentable square feet, now owns the most energy-efficient buildings in a single portfolio in the nation. As a result, the firm has reduced its annual energy costs by approximately \$4.8 million through energy efficiency measures. Another example is provided by one of the nation's largest owners of office buildings (700 office buildings nationwide), which is installing distributed generation equipment at 12 of its buildings as a pilot project. While each system costs as much as \$5 million, the owner believes it can recover the cost over time by reducing the amount of electricity it has to buy from the grid during times of peak demand. (Source: Innovest Strategic Value Advisors, "Energy Management and Investor Returns: The Real Estate Sector," (October 2002); Jeffrey Ball, "Energizing Off-Grid Power," Wall Street Journal (August 18, 2003).)

• A minimal upfront investment of about 2 percent of construction costs in sustainable building practices and products typically yields life cycle savings of more than 10 times the initial investment, according to a recent study commissioned by California's Sustainable Building Task Force. (Source: Greg Kats et al., The Costs and Financial Benefits of Green Buildings: A Report to California's Sustainable Building Task Force (October 2003).)



# CALIFORNIA PUBLIC EMPLOYEES' RETIREMENT SYSTEM BOARD OF ADMINISTRATION INVESTMENT COMMITTEE

# MINUTES OF MEETING OPEN SESSION

November 14, 2005

The Investment Committee met on Monday, November 14, 2005 in the Lincoln Plaza North Building, 400 Q Street, Auditorium, Sacramento, California.

The meeting was called to order at approximately 1:00 p.m. and the following members were present:

Charles Valdes, Chair
George Diehr, Vice Chair
Ron Alvarado
Philip Angelides, represented by Ted Eliopoulos
Marjorie Berte
Robert F. Carlson
Rob Feckner
Priya Mathur
Michael Navarro, represented by Debbie Endsley
Tony Oliveira
Mike Quevedo, Jr.
Kurato Shimada
Steve Westly, represented by Toni Symonds and Joy Higa

The meeting recessed from 1:05 to 1:15 p.m.

#### AGENDA ITEM 2 - APPROVAL OF AGENDA

There were no changes to the open session agenda order.

### **AGENDA ITEM 3 – APPROVAL OF OCTOBER 2005 MEETING MINUTES**

On **MOTION** by Mr. Diehr, **SECONDED** and **CARRIED** that the October 17, 2005 Open Session minutes be approved as presented.

# AGENDA ITEM 4a - REAL ESTATE, Real Estate Annual Plan

Mike McCook, Senior Investment Officer, and Al Fernandez, Senior Portfolio Manager, presented the item. Nori Gerardo Lietz, Pension Consulting Alliance, was available to respond to questions from the Committee.

The presentation included a performance review of the global real estate portfolio, past year highlights, accomplishments, and 2005-06 challenges and initiatives. The overall real estate return of 51.4% for the fiscal year ending June 30, 2005 reflects the highest return of record for a one-year period.

On **MOTION** by Ms. Berte, **SECONDED** and **CARRIED** to approve the 2005-2006 Real Estate Annual Plan.

# AGENDA ITEM 5a – ALTERNATIVE INVESTMENT MANAGEMENT (AIM) PROGRAM, AIM Annual Plan

Leon Shahinian, Senior Investment Officer, and Joncarlo Mark, Senior Portfolio Manager, presented the item. The presentation included a review of performance, the recent year's accomplishments, and key priorities for the upcoming year.

On **MOTION** by Mr. Diehr, **SECONDED** and **CARRIED** to approve the 2005-2006 AIM Annual Plan.

# AGENDA ITEM 6a – GLOBAL EQUITY, International Fund Service (IFS) Contract Renewal

Christy Wood, Senior Investment Officer, and Kurt Silberstein, Portfolio Manager, presented the item. Gina Greer, Staff Counsel, stated that the Legal Office had conferred with Investment staff regarding the requirements for a best business practices exemption.

On **MOTION** by Ms. Mathur, **SECONDED** and **CARRIED** to approve (1) an exemption from competitive bidding based on Best Business Practices for the contract to provide the portfolio management platform for the Risk Managed Absolute Return Strategies Program, (2) an annual review contract to International Fund Services for these services, and (3) that it be brought back to the Committee for review no less than once every three years.

# AGENDA ITEM 6b – GLOBAL EQUITY, Selection of Environmental Public Equity Managers for Spring-Fed Pool

Christy Wood, Senior Investment Officer, Winston Hickox, Special Consultant, and Mary Cottrill, Senior Portfolio Manager, presented the item. Michael Schlachter, Wilshire Associates, was available to respond to questions from the Committee.

# On **MOTION** by Mr. Feckner, **SECONDED** and **CARRIED** to approve:

 The following group of managers for inclusion in the Spring-Fed Pool of managers for environmental equity investment management services, subject to successful negotiation of fees and terms.

AXA Rosenberg U.S. Equity
New Amsterdam Partners U.S. Equity
Piper Jaffray & Co. – INTECH U.S. Equity
State Street Global Advisors U.S. Equity

Brandywine International Equity
State Street Global Advisors International Equity

2. The use of annual review contracts for the Spring-Fed Pool for environmental equity management services.

# AGENDA ITEM 6c - GLOBAL EQUITY, New Enhanced Indexing Initiative

Christy Wood, Senior Investment Officer, and Mary Cottrill, Senior Portfolio Manager, presented the item. Michael Schlachter, Wilshire Associates, was available to respond to questions from the Committee.

This was information item to explore and seek input from the Investment Committee on the concept of including, as part of CalPERS' external public equity program, U.S. and international (developed markets) managers of enhanced indexing products that include a relaxation of the long-only constraint. This is a new strategy for CalPERS that would complement the existing lineup of traditional active and enhanced equity managers.

The Committee expressed interest in the strategy and requested that additional information be provided at a future meeting.

# AGENDA ITEM 6d – GLOBAL EQUITY, Corporate Governance Internal Staff Working Group Update

There were no items to report.

# AGENDA ITEM 6e – GLOBAL EQUITY, PacifiCare and United Health Merger

Christy Wood, Senior Investment Officer, and Dennis Johnson, Senior Portfolio Manager, presented the item.

There was a discussion regarding:

- PacifiCare's proxy statement and merger timeline as it related to the executive compensation agreements.
- How the Committee should convey its concern about poor corporate governance practices and excessive executive compensation.

On **MOTION** by Mr. Eliopoulos, **SECONDED** and **CARRIED** to approve opposing the merger unless the executive compensation packages triggered by the merger are brought back for a separate vote by the shareowners for approval.

The Chair directed Legal staff to seek advice from outside counsel and the California Attorney General with respect to the legality of PacifiCare's actions related to the executive compensation packages.

# AGENDA ITEM 7 – GLOBAL FIXED INCOME, International Fixed Income Managers Annual Review

Curtis Ishii, Senior Investment Officer, Eric Busay, Portfolio Manager, Investment Officers Jonathon O'Donnell and Omid Rezania presented the item. Roz Hewsenian, Wilshire Associates, was available to respond to questions from the Committee.

On **MOTION** by Mr. Feckner, **SECONDED** and **CARRIED** to renew the contracts for all CalPERS' external international fixed income managers for a period of one year. The five managers are:

Baring Asset Management
Julius Baer Investments Limited
Bridgewater Associates
Rogge Global Partners
Western Asset Management

# AGENDA ITEM 8a – CHIEF INVESTMENT OFFICER'S / ASSISTANT EXECUTIVE OFFICER'S REPORT, Consolidated Investment Activity Report

Mark Anson, Chief Investment Officer, presented the item.

The Committee accepted the Consolidated Investment Activity Report. The total market value of the fund as of September 30, 2005, was approximately \$195.5 billion and the total book value was approximately \$151.0 billion.

# AGENDA ITEM 8b - CHIEF INVESTMENT OFFICER'S / ASSISTANT EXECUTIVE OFFICER'S REPORT, Amendment to Primary Pension Consultant Contract

Staff were available to respond to questions from the Committee regarding this item.

On **MOTION** by Mr. Feckner, **SECONDED** and **CARRIED** to authorize the augmentation of the Primary Consultant Contract No. 2005-3632 (Wilshire Associates) up to a maximum of 35% to allow subcontracting with best in class firms to assist with permissible equity country research.

# AGENDA ITEM 8c - CHIEF INVESTMENT OFFICER'S / ASSISTANT EXECUTIVE OFFICER'S REPORT, Global Equity Internally Executed Asset Transition

Mark Anson, Chief Investment Officer, reported that as a result of acquiring the ability to process international equity transactions in-house we were able to save \$2 million on the latest transition.

### AGENDA ITEM 9 - DRAFT DECEMBER 2005 AGENDA

The Committee accepted the proposed December 12, 2005 agenda and the Chair directed that a presentation regarding gasoline production be scheduled for 1:00 p.m.

### **AGENDA ITEM 10 – PUBLIC COMMENT**

There were no comments from the public.

The meeting was adjourned at 3:30 p.m.

The next meeting of the Committee is scheduled for December 12, 2005 in Sacramento, California.

FRED BUENROSTRO
Chief Executive Officer